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LESSONS SUGGESTED BY THE EXPERIENCE OF THE FRENCH PEOPLE AND OF THE BANK OF FRANCE

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WHEN I wrote in the *Yale Review* and *Moody's Magazine* in 1906 and 1907 concerning the need of a monetary commission I suggested that the important work of such a commission should embrace the following lines of research :

1. The collection of reliable information bearing upon these questions.
2. The recommendation of remedial legislation for the present extraordinary condition of affairs.
3. Coöperation with commissions of other countries ; for the problems require international action for their solution.
4. Recommendations for a comprehensive reform of our entire monetary and currency systems.
5. Recommendations for a systemization of our credit system, and a national organization of the clearing houses of the country.¹

I little dreamed that within three years all that I wished to know regarding the current systems of exchange as practised by the great nations, written by their own experts, would be available in the shape of the magnificent reports of the Monetary Commission.

In the history of money and banking, the work of Senator Aldrich will stand forever as an example of the way a congressional commission may work to present the evidence to the end that all experience may be gathered together for the present benefit of mankind. As I have glanced over each report of this series of monographs, replete with original data, statistics and careful generalizations, I have realized anew the possibilities

¹ See *Moody's Magazine*, "Necessity of a Gold Commission," Sept., 1907; and *Yale Review*, "Gold Depreciation," October, 1906.

of national progress through the use of commissions and experts. In the investigations of the Monetary Commission, Senator Aldrich has eclipsed his earlier brilliant researches contained in the Senate *Report on the Course of Wholesale Prices and Wages*, published nearly two decades ago.

Before students of the theory of money and banking as well as before all students of social progress, two ideals are clearly presented: social progress by reduction of waste in existing institutions; social progress by substitution of more efficient institutions for existing institutions, thereby reducing the total social waste.

The creation of the Bank of France was, as André Liesse shows in his monograph on the *Evolution of Credit and Banks in France*,¹ a result of the strong will of the great Napoleon. Napoleon said: "I have created the Bank in order to allow discount at 4 %." Seldom, indeed, in the course of more than a century has the Bank of France charged more than 4 % for discount. The Bank of France is an excellent illustration of social progress by substitution of a new method. Let us look clearly at the problem solved by Napoleon and the Bank of France,—problems which confront all peoples.

One notable line of social progress lies along the path of exchanging commodities with greater and greater economy. Economists have divided the inventions of social exchange into groups, such as money as a standard of value for expressing the prices of the commodities of commerce, money as means of exchange, credit and institutions of credit. Governments have generally acted to define the standards of value, to create media of exchange and to license or regulate institutions of credit.

Napoleon asked Mollieu, the expert banker who composed the famous Havre Note, to write clearly in his report: "Who issues the bank notes? Who receives the profits? Who furnishes the funds?" So today we may inquire of our experts, "Can our standard of value be improved? Can our media of exchange be bettered? Can the distribution of credit in our country become more general?" Some of these ques-

¹ Published by the National Monetary Commission.

tions are abundantly answered by the experience of the French people and of the Bank of France.

The lessons to be drawn from the experience of the Bank of France and of the French credit institutions are to be found preëminently along lines of a more perfect mechanism for credit operations. How the French system gathers together the idle savings of all of the people and renders it possible to lend out these funds at low interest in a productive manner is demonstrated by Patron,¹ Liesse² and Neymarck,³ in their respective monographs. These experts have shown the wonderful possibilities of a bankers' bank with branches everywhere, existing for the purpose of rediscounting short-term commercial paper. They have conclusively shown how low and how stable is the discount rate under such a system. They have proved that France has weathered with serenity the gravest crises,—whether produced by war or by over-speculation in other countries,—by reason of her splendid banking system.

But, inasmuch as excellent institutions when transplanted must be readjusted to different conditions, how, it may be asked, shall we utilize this French experience? What are the objects which we should strive to obtain? In seeking better monetary and credit systems, the following objects are paramount:

1. Safety so that crises shall be prevented.
2. Low uniform discount rates on commercial paper so that commerce and industry may thrive.
3. General distribution of credit so that small concerns as well as large corporations may have opportunity to borrow at reasonable rates.
4. Opportunity for all the people to secure interest upon their savings, however small, with absolute safety of principal, so that an enor-

¹ *The Bank of France in its Relation to National and International Credit.* By Maurice Patron. Washington, 1910. National Monetary Commission. (Senate doc. 494, 61st cong., 2d sess.)

² *Evolution of Credit and Banks in France.* By André Liesse. Washington, 1910. National Monetary Commission. (Senate doc. 522, 61st cong., 2d sess.)

³ *French Savings and their Influence upon the Bank of France and upon French Banks.* By Alfred Neymarck. Washington, 1910. National Monetary Commission. (Senate doc. 494, 61st cong., 2d sess.)

mous concealed wealth may become available for the development of the prosperity of all.

5. Better facilities for obtaining loans upon commodities, when produced, by a system of licensed warehouses, under federal inspection.

6. Complete development of our clearing-house system so that what the local clearing house is to the banks of a city, a national clearing house shall be to the clearing houses of the country, when operated in coöperation with a central bank.

7. Adequate organization of the foreign exchange market so that our foreign commerce may be assisted.

8. Measures calculated to make more uniform the standard of value so that the bitter class contests, attended by strike, lockout and great popular discontent, shall be lessened. All of these are produced largely by sudden changes in price levels, increasing or decreasing suddenly the cost of living for the millions of our working people.

Let us consider briefly, in the light of the French experience, how we may frame legislation to secure the objects desired.

I. Crises are notoriously produced by a chain of events which may be summed up by the phrase "miscalculation of probable profits, which turns out really to have been over-speculation." For commerce, the "calm health of nations," becomes "feverish over-speculation" only when merchants miscalculate their probable profits.

Inasmuch as calculations of probable profits depend largely upon what merchants expect to get for their goods and to pay for their credits, it follows as the pattern follows the blow of the drop-hammer that sudden and violent changes in commodity prices or in discount rates turn probable profits into losses, producing failures and crises.

How may a law be framed to prevent forever the recurrence of crises,—and the suspension of specie payments by the banks, so long as the country remains upon the gold standard of value? To secure stability of banking institutions, the common practise has been to limit by law or by direction of the governors of the bank the ratio of cash reserves to immediate liabilities such as deposits. Naturally this ratio as a limit between the danger and safety zones in banking, was early thought of, inasmuch as 100% of cash to deposits means absolute safety. On the

other hand, the profits of a bank increase as this ratio is reduced. In the United States, the statute requires 25% cash reserves to deposits for the central-reserve cities, 12½% for the reserve cities and 6% for the country banks. A disproportionately larger growth of institutions outside the national reserve requirements, such as of trust companies, state and private banks, must reduce for our whole banking system the safe average of cash to deposits. This was a potent condition underlying the suspension of specie payments in 1907.

Inasmuch as the points of weakness even in severe crises are comparatively few in number, the failure of a few banks on account of isolated reserves produces grave consequences. The need is for a united reserve, which is the advantage afforded by a central bank.

II. The United States needs, beyond any other financial reform, the establishment of a central bank.¹ A central bank is the economic mechanism which makes interest more uniform over a wide area. The central bank is an institution which lends to banks in every locality, receiving in exchange for the cash advanced the local bank's most liquid assets, which are commercial loans coming due within four to thirty days.

The merchants of New Orleans may require funds in large quantity during a given fortnight. If business is active, the banks may be loaned up to the limit of the reserve requirements. Nothing remains for the bank to do but to raise the discount rate on new loans as the old loans mature, which is really selling the available credit to the highest bidder. Could the banks at New Orleans rediscount with the central bank the notes which would be coming due within a week or ten days, so much additional credit is instantly available for the use of the merchants of New Orleans. Could the banks of the north re-purchase these notes from the central bank, when properly guaranteed, or could new notes of the central bank be issued against such liquid assets, the earning power of the northern banks would be increased, as in this way employment might be found for idle funds.

¹ See my article, "Central Bank as a Federal Clearing House," *Moody's Magazine*, Sept., 1910.

A central bank would charge enough for its services to continue upon a self-supporting basis. Abundant experience is available with reference to such points. The hope of profit cannot be overpowering in the minds of the governors when all earnings above 4 % go to the treasury of the United States, which is the suggestion of Mr. Paul Warburg, expert for the Monetary Commission.

A central bank should exist to serve the nation as a whole. The dividends to the stockholders may be small, but the services to the merchants of the country would be great indeed. The real gains are lower interest rates to merchants, and above all, much less risk of sudden crisis, which is so demoralizing to business success.

The chance of a crisis is reduced, because a great central institution is in a position to command sobriety, to meet financial storm with equanimity and to make available for the development of our local industries the vast surplus wealth of Europe.

Eighteen thousand banks at present, each with a separate reserve and independent of each other, are eighteen thousand sailboats on the water. In fair weather, everything is serene and every sail is set. In a sudden storm like that of 1907, nearly all suddenly take in sail and a large number disastrously capsize. A central bank, on the other hand, is a mammoth ocean liner, built to withstand the tempests.

Besides acting as a federal clearing house, as illustrated above, for the general distribution of credit among all the eighteen thousand banks of the country, a central bank would buy and sell government bonds, deal in foreign exchange and maintain branch offices at important centers throughout the United States.

If the capital stock of the central bank, whether one or two hundred millions of dollars is not essential, were distributed in ownership among the eighteen thousand banks, the merchants of the country and the public at large, with the provisions that each stockholder should have only a single vote, and further that all earnings above 4 % should go to the government, all possibilities of one-man control or of excessive profits would be made impossible at the start.

III. Much may be accomplished in the direction of more general distribution of credit by the combination of the central bank, the postal-savings-bank system and a system of licensed warehouses under federal inspection, when established. The desideratum is to render it easy for all who desire credit to obtain it on the security of commercial stocks, whether merchants' goods in stores and warehouses or farmers' commodities produced and awaiting marketing. The French law "constitutes the landowner, so to speak, a public warehouse. It is he who, without any other controlling appraisement, makes declaration as to quantity and commercial value to the clerk of the justice of the peace. In short, the agriculturist enjoys a confidence which so far has been denied to industry and commerce."¹

IV. That the system of postal savings banks already provided by law will collect a vast amount of capital which is now hoarded is extremely probable. This additional capital, in whatever way invested, will afford additional funds as a basis for credit to the advantage of all. At the same time, it is to be hoped that the administration will work out the operation so successfully that at an early date a safe place to deposit money in small amounts will be provided generally throughout the United States.

V. Goods stored in warehouses are a desirable basis for the extension of credit. Cheap storage with large reserves of commodities is an excellent thing for the nation as a preparation for war. Some system of licensing warehouses and maintaining proper statistics describing goods stored as a basis of credit is desirable. Why should not such credit be extended to tenants by the warehouses complying with government requirements as to inspection, by arrangement directly with the central bank? The central bank would become an even greater aid to the development of our commerce and industries.

VI. America is noted for the development of the clearing-house system. On account of an inelastic system of credit, a strong motive has been present to economize the use of coin. In France, the central bank has performed this function to a large

¹ Patron, p. 162.

extent in other ways. It is desirable that a system of clearing between clearing houses should be organized, which may be easily accomplished in coöperation with a central bank.

VII. Just as the clearing-house system should be extended in coöperation with the central bank, every effort should be made to extend the system of clearing international indebtedness in the most efficient manner. In order that our merchants may compete in shipments to foreign countries, foreign exchange rates must become more favorable to our country. Such an organization tending to make more favorable foreign exchange conditions may be furnished by the branches of a great central bank. Much progress is possible in this field. Every effort should be made to extend our commerce with foreign countries; whether by reciprocity or free trade is not essential.

VIII. Says Patron, in his brilliant monograph;

“ the interesting evolution of means of exchange which we are witnessing and which is familiar to everybody seems to be leading us, after the well-defined periods of barter and money, to a system of mere clearings of balances. All exchange operations would then be settled by simple book transfers. Coin, thus reduced to the condition of money of account, would cease to play any real part. Economists are even thinking of a return to barter, which would complete the cycle, bringing us back to the original state after thousands of years and combinations of all kinds. Such would be the course of this evolution.”

That this evolution will be hastened by the lack of stability of the gold standard seems probable. How violently price levels have fluctuated with the vast increase in the production of gold¹ may be indicated by any one of the important series of index numbers.

If we express the value of gold in the multiple standard as computed by the Dun index numbers, and their continuation, the so-called Gibson Index numbers,² using the average prices of 1890-99 as our base 100, we are able to frame a table show-

¹ See my article on the “Gold Flood,” *Cosmopolitan Magazine*, June, 1910.

² See my article, “A Revised Index Number for Measuring the Rise in Prices,” in *Quarterly Journal of Economics*, Aug., 1910.

ing the premium or discount on gold each year in the multiple standard.

Table Showing the Premium or Discount on Gold Expressed in the Multiple Standard, Base = 100, Average 1890-99 Prices.

	Price of Gold.	Depreciation Compared with the Average 1890-9.
1900	91	9 %
1901	91	9 %
1902	83	17 %
1903	85	15 %
1904	88	12 %
1905	86	14 %
1906	80	20 %
1907	77	23 %
1908	80	20 %
1909	75	25 %
1910 1st 9 mos.	72	28 %

It is plain that gold has depreciated to an alarming extent. This heavy depreciation in the gold standard measured in the multiple standard shows how grievous has been the burden on the working classes. Had wages been paid in the multiple standard rather than in gold, the cost of living would have remained relatively constant for our working classes.

In this connection, the Massachusetts Commission on the Cost of Living suggests the legalization of a multiple standard, concluding:

It is hard to see how any harm could come from giving official aid to the maintenance of such a standard for the use of any borrowers and lenders who chose to adopt it. In the event of long continuance of the upward movement of prices, its use might prevent serious injustice and great hardship. We recommend that our senators and representatives consider the expediency of advocating its establishment.

The advantages of such an optional standard for wage contracts would be very great. On the one hand, during periods of rising prices in gold, the cost of living would be met automatically by increasing real wages, and on the other hand in periods of declining gold prices, wages would decrease in proportion with the cost of living, preventing temporary social

extravagance at such times among our laboring classes and resulting crises in our industries after a little time. How such a readjustment can be early made, I have discussed in an article on "The Remedy for High Prices."¹

To prevent another crisis with all the disastrous consequences, we need quick action by Congress. It is to be hoped that such legislation will be produced at the coming session. These monetary problems are non-partisan. Great credit is due the Monetary Commission for their work. The legislation for postal savings banks is already a reality. In brief summary, let us adopt those measures which experience shows to be both wise and necessary.

Let us have a central bank somewhat similar to the Bank of France, a banker's bank with branches at convenient points, at which all banks of every character may rediscount commercial paper. Such an institution will mean much in the stable development of business. For a reasonably uniform low rate of discount guarantees for a new country great prosperity.

Let us have a successful administration of the postal savings banks so that our people may find a safe depository for their funds at every post office in the land.

Let us encourage all our people to own the bonds of the United States government, since thereby social solidarity is increased. To this end we should place the bonds upon an investment basis, raising the interest rate, and so arranging that United States bonds in small denominations may be purchased at every postoffice.

Let us, either through the central bank or by an independent institution, provide a national clearing house which shall supplement the work of all local clearing houses of the United States.

Let us provide an optional multiple standard in which wages may be paid when so agreed upon in advance. Should the government daily publish the value of gold in the multiple standard based on fifty to one hundred leading commodities, the rate of wages so expressed would vary with the cost of living so that in times of rising prices higher wages would accom-

¹ *Independent*, Feb. 10, 1910.

pany increasing cost of living. With the present violent fluctuations in prices under the gold standard, strikes, lockouts and great popular discontent are caused by rapidly rising prices, and widespread social extravagance by prices falling suddenly and more rapidly than wages.

Let us have licensed storehouses in which commodities stored away become more readily the basis of credit, to the great benefit of our agricultural and merchant classes.

Let us in short have a money and a credit code of law so perfect that it shall become a model for all the nations of the world,